MONTANA

DRINKING WATER STATE REVOLVING FUND

ANNUAL REPORT

FOR STATE FISCAL YEAR 2002
(JULY 1, 2001 THROUGH JUNE 30, 2002)

Prepared by

Montana Department of Environmental Quality
and
Department of Natural Resources and Conservation

for
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DRINKING WATER STATE REVOLVING FUND (DWSRF)
ANNUAL REPORT
STATE FISCAL YEAR (SFY) 2002

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I. INTRODUCTION

This Annual report adheres to the Operating Agreement negotiated between the State of Montana and the Environmental Protection Agency (EPA) concerning the administration of the Drinking Water State Revolving Fund (DWSRF). The annual report summarizes DWSRF activities for the state fiscal period beginning July 1, 2001 and ending June 30, 2002 (SFY02).

The DWSRF program was established as a result of the 1996 Amendments to the Federal Safe Drinking Water Act, which provided the authority for EPA to make capitalization grants to states. The grants, in conjunction with state matching funds, are used to provide financial assistance for the construction of drinking water projects and to support administration of the state program.

In anticipation of the 1996 Amendments to the Federal Act, the 1995 State Legislature, under Title 75, Chapter 6, Part 2, Montana Code Annotated, passed the enabling legislation, entitled the Safe Drinking Water Treatment Revolving Fund Act, giving authority to the Montana Department of Environmental Quality (DEQ) and the Department of Natural Resources and Conservation (DNRC) to adopt administrative rules to implement the program. Legislation also provided ability to generate state match funds, through the sale of state General Obligation Bonds (GO Bond Authority). Amendments to the Drinking Water State Revolving Fund Act were passed in the 1997, 1999 and 2001 Legislative Sessions. The 1997 amendments changed the title of the Act from "Safe Drinking Water Treatment Revolving Fund Act" to the "Drinking Water State Revolving Fund Act" and also made other changes consistent with the Federal Act. During the 1999 Legislative Session, the 1999 amendment clarified the transfer language between the DWSRF and Water Pollution Control State Revolving Fund (WPCSRF) Programs and added GO Bond Authority. The 2001 Amendment authorized the program to advance funds to projects funded, in part, by the federal government when federal funding has been approved but not appropriated. This provides interim financing until those federal funds become available.

II. EXECUTIVE SUMMARY SFY02

During SFY02 Montana applied for and was awarded its sixth capitalization grant in the amount of $8,052,000 for FFY02.

Since the inception of the DWSRF, Montana has issued three GO bonds and one Bond Anticipation Note (BAN). The proceeds of which have been used as state match for loans, set asides, and program administration. Montana issued its first GO bond in October 1998 (SFY99), the second GO Bond in April 2000 (SFY00), and the third GO bond in June 2001 (SFY01). The total amount of bonds issued to date is $9,245,000. A summary of these bond issues is provided in Exhibit 1. Montana is planning for its fourth GO Bond in calendar year 2003.

Exhibit 1, Sources of DWSRF Funds Through SFY02, provide a complete tabulation of capitalization grant awards received through June 30, 2002, projected state match, binding

commitments for loan projects through SFY02, and GO bonds and BANs issued for state match. The combination of capitalization grants and bond proceeds provide the needed funds for DWSRF projects, set asides, and program administration during SFY02. In addition, DNRC provided a portion of their program administration services as an in-kind contribution in the amount of $11,779 for SFY02.

During SFY02, the DWSRF program executed 8 project binding commitment agreements totaling $3,281,000, and increases of three prior commitments in the amount of $214,000, with total commitment of funds of $3,495,000 for the period. For a detailed breakdown of all DWSRF binding commitments signed and key dates of project activity that occurred in SFY02, refer to Exhibit 2: DWSRF SFY02 Binding Commitments Executed. See Exhibit 3 and 4 for the closed loans.

Detailed information concerning use of DWSRF funds, accomplishments of the program and adherence with the stated goals of the program are provided on the following pages.

III. GOALS OF THE DWSRF

Long-Term Goals

1. To continue building and maintaining a permanent, self-sustaining state revolving fund program that will serve as a cost-effective, convenient source of financing for drinking water projects in Montana.

   Projects funded during SFY02 met all program requirements governing financial capability to assume debt. Nine of twelve communities received an interest rate of 4.0% on their loans (well below market rates) and three of the twelve qualified for an interest rate of 3.0% under the disadvantaged community criteria. These factors illustrate that the assistance is affordable. Refer to Exhibit 3 & 4. A copy of the cash flow with all the activity through SFY02 is included in the report as Appendix A.

2. To provide a financing and technical assistance program to help public water supplies achieve and maintain compliance with federal and state drinking water laws and standards for the protection and enhancement of Montana's public drinking water.

   To promote the availability of these DWSRF program services during SFY02, DWSRF staff presented information at a variety of events. These included four infrastructure workshops and the annual Montana Rural Water Systems conference, as well as meeting one on one with community leaders.

   Please also refer to the project descriptions and discussion of set-asides provided in Section V: Details of DWSRF Activity.

Short-Term Goals

1. Continue implementation and maintain the Drinking Water State Revolving Fund Program in Montana.

   Montana received approval of its DWSRF program and award of the FFY97 capitalization grant on June 30, 1998. Five additional capitalization grants have been received since then,

including the FFY02 Grant for $8,052,500 that was received during SFY02.

2. Ensure the technical integrity of Drinking Water SRF projects through the review of planning, design plans and specifications, and construction activities.

   The trained technical staff of the Planning, Prevention and Assistance Division (PPAD) continue to use the DWSRF Handbook of Procedures and knowledge gained from nine years of operating the WPCSRF Program to ensure that this objective is met. The Handbook of Procedures is used as a guide to ensure that all state and federal laws governing the technical aspects of each project are satisfied.

   Steps were taken to update the Handbook of Procedures and streamline checklists and processes. This project was completed in early SFY02. A final revised edition was submitted to EPA in September 2001.

   Staff attends training seminars and workshops to maintain and improve technical, financial and programmatic knowledge. In SFY02, Anna Miller, John Tubbs, Diana Hoy and Bob Fischer attended the Council of Infrastructure Financing Authorities (CIFA) National Workshop; Anna Miller, Diana Hoy, John Patrick, Jeff Lustgraaf, Marc Golz, Gary Wiens and Bob Fischer attended the DWSRF All States Workshop; Anna Miller attended the CIFA Legislative Conference; and Bob Fischer attended the annual Joint Engineers' Conference.

3. Ensure the financial integrity of the Drinking Water SRF program through the review of the financial impacts of the set-asides and disadvantaged subsidies and individual loan applications and the ability for repayment.

   See Appendix A: Cash Flow Model SFY02.

4. Ensure compliance with all pertinent federal, state, and local safe drinking water rules and regulations.

   To the best of our knowledge, the DWSRF program has ensured Public Water Supply Supervision (PWSS) compliance through the projects that have been funded and the various set-aside activities. Close coordination with the PWSS program has been essential in this effort.

5. Obtain maximum capitalization of the funds for the state in the shortest time possible while taking advantage of the provisions for disadvantaged communities and supporting the set-aside activities not directly related to the loan portfolio.

   Since the approval of its DWSRF loan program and first capitalization grant award, Montana has been awarded five more capitalization grants, utilized the provision to transfer funds between the WPCSRF and DWSRF, and generated other revenue from loan repayments and interest investments. The loan fund now totals over $50,000,000.

IV. FINANCIAL REPORTS

The Montana Legislative Audit Division (LAD) has completed their audit work of the SFY01 financial statements and will present their audit report to the Legislative Audit Committee (LAC) in November 2002, an unqualified opinion should be issued for the financial statements. A copy of the report will be submitted to EPA Region VIII, once it has been approved by Montana's

Legislative Audit Committee.

DEQ and DNRC engaged LAD to audit the State Revolving Fund financial activity beginning in SFY98. This decision was based on a new audit requirement conveyed in a directive from the Office of Water, Inspector General's Office, and the Office of Management and Budget. Prior to SFY98, LAD performed an annual review.

A copy of the SFY02 unaudited financial statements, including footnotes is attached as Appendix B of this report. The LAD has completed their audit of the SFY01 DWSRF activity. The SFY02 audit should be complete by May 2003.

V. DETAILS OF DWSRF ACTIVITY

A. LOAN ASSISTANCE

During SFY02 the DWSRF program closed twelve loans; signed eight project binding commitment agreements; and increased three binding commitments.

Project Bypass

If it is determined by DEQ that a project or projects are not ready to proceed or that the project sponsors have chosen not to use the Drinking Water SRF funds, other projects may be funded in an order different from that indicated on the priority list. If DEQ chooses to bypass higher ranked projects, it should follow the bypass procedure.

Montana bypassed 48 projects on its Priority List with the funding of Gardiner-Park County Water District, ranked 60. Eleven other loans were closed. Refer to Exhibit 3: DWSRF Capitalized Grant Closed Loans For SFY02 and Exhibit 4: DWSRF Recycled Closed Loans For SFY02. The notification included the proposed projects to be funded, and the assurance that funds were still available for all loan applications anticipated at that time. All communities on the Priority List were notified in accordance with the above procedures, and no responses were received. No emergency projects were funded in SFY02.

Disadvantaged Communities

Communities seeking a Drinking Water SRF loan that meet the disadvantaged community criterion described in the Intended Use Plan may receive an additional subsidy on their SRF loans, beyond the standard below-market rate financing. This includes communities that will meet the disadvantaged criterion based on projected rates as a result of the project.

In SFY02, Montana closed three loans at a 3% interest rate, in the amount of $832,000, with all three communities satisfying the disadvantaged criteria.

Small Systems

The table on the next page shows the breakdown of the population served by our loans in FY02. We have 12 loans for a total of $7,030,000. Eleven of these loans are with small systems that serve a population of less than 10,000 for a total of $5,780,000. Small systems represent 82% of the loans made in FY02.

Public Water Supply	Population	Loan Amount
1. Choteau	1781	$332,000
2. Colstrip	2346	$829,000
3. Conrad	2753	$1,486,000
4. Eureka	1017	$619,000
5. Gardiner-Park County (A)	500	$170,000
6. Gardiner-Park County (B)	500	$330,000
7. Gardiner-Park County (C)	500	$267,000
8. Helena	25,780	$1,250,000
9. Highwood W & S District	280	$75,000
10. Geraldine	284	$129,000
11. Shelby (A)	3216	$866,000
12. Shelby (B)	3216	$677,000
TOTAL		**$7,030,000**

Projects Provided Funding

Following is a brief summary of the projects that began or continued activity during SFY02:

The Town of Cascade construction loan refinanced a new deep well into the Madison aquifer formation and the connecting piping to tie this source into the town's water supply. All work was completed in late spring of 2001. The town then submitted an application to the DWSRF to help refinance a small portion of the total project cost; the final loan disbursement was made in May 2001. This project will help Montana meet its intended use plan goals of ensuring the town is able to meet both water quality and quantity requirements over the next 10 to 20 years. Funding this project addresses public health protection through compliance with the Total Coliform Rule. Historically, Cascade has experienced coliform bacteria problems associated with a spring source and has also abandoned one of the town's largest wells due to a leaking underground storage tank.

The City of Choteau construction loan was used to fund the installation of water meters throughout the system. Begun in the fall of 2001, the project was completed early in 2002. The goal of the project was to promote conservative use of drinking water and to enable the community to better monitor leakage and efficiently maintain its distribution system in compliance with the capacity development requirements of EPA and the Montana Drinking Water State Revolving Fund Loan Program.

The City of Colstrip construction loans (Phase I & II) funded design and construction of water main replacement work. The existing water system was installed in the 1950s and much of the existing infrastructure must be replaced. Phase I construction work began in June 2001 and was completed in September 2001. Phase II construction began in the spring of 2002 and final inspection is expected in September 2002. Funding this project addresses public health protection through system maintenance to minimize leakage and potential cross connections.

The City of Conrad construction loans (Phase I & II) funded design and replacement of old filter under drain and backwash systems and installation of a new pre-treatment process (ballasted sedimentation). The Phase I project was completed in 2001 and the construction of

Phase II began in fall of 2001. This project will help Montana meet its intended use plan goals of ensuring the city is able to meet both water quality and quantity requirements over the next 10 to 20 years. Funding this project addresses public health protection through compliance with the Surface Water Treatment Rule. Conrad has had difficulty meeting turbidity requirements intermittently during the past couple of years.

The Town of Eureka construction loan is funding the installation of 475 new water meters, rehabilitation of an existing 0.5 MG steel reservoir, and construction of a new ultraviolet disinfection system, 30-inch distribution main, and a deep well. In 1998 the primary water source for the town was classified as groundwater under the direct influence of surface water. The new disinfection facilities are being constructed in an effort to meet the criteria to avoid filtration of surface water. The disinfection facilities are also designed to comply with the future requirements of the Long Term 2 Enhanced Surface Water Treatment Rule (LT2ESWTR). The total loan amount is expected to be $619,000. Construction began in the spring of 2002 and should be complete by the end of 2002. This project helps Montana meet its intended use plan goals of ensuring the technical integrity of the project and funding a project that addresses public health protection through compliance with the Surface Water Treatment Rule and the upcoming LT2ESWTR.

The Fort Peck Rural County Water District construction loan funded the construction of water system improvements to meet increased demand within the District boundaries. Existing individual groundwater supplies within this area do not meet drinking water quality standards. The project consists of the expansion of the town of Fort Peck's water treatment plant, improvements to the town's transmission and storage facilities, and the construction of a distribution system to serve the Fort Peck Rural Water District. The total loan amount is $1,520,000. Construction began in September 2000 and the District and engineer signed the construction completion certification in June 2002. This project helps Montana meet its intended use plan goals of ensuring the technical integrity of the project and funding a project that addresses public health protection by providing water to areas that meets water quality standards.

The Gardiner-Park County Water District loans funded distribution system improvements and a new well. Water mains that were undersized and/or not buried deep enough to prevent freezing, were leaking or were in danger of failure were replaced. Three loans were utilized. Two loans in the amounts of $330,000 (Loan B) and $267,000 (Loan C) were made to refinance a loan that Gardiner used for a new well and distribution system improvements. A third loan for water main replacement was made in the amount of $170,000 (Loan A). The construction of that project is complete, but the final draw has not been made. The projects helped Montana meet its intended use plan goals by proactively addressing distribution system problems, building system capacity and by ensuring the technical integrity of the project.

The Town of Geraldine construction loan is funding the installation of new water meters, chlorination system improvements, and a new well control system. The total loan amount is expected to be $129,000. Geraldine had an inadequate well control system that led to occasional tank overflows. Water was also used inefficiently because rates were not linked to water use. Construction of the improvements began in May 2002 and will be finished in the fall of 2002 with the completion of the well control system. Funding this project addresses public health protection through system improvements to increase chlorination reliability. In addition, water supply is enhanced by eliminating tank overflows and encouraging water conservation.

The City of Glendive loan funded improvements to the surface water treatment plant. The city

borrowed $1,565,000 to construct a new intake in the Yellowstone River and construct a new clearwell to improve chlorine contact time. The project helped Montana meet its IUP goals by improving the reliability of the source and protecting public health by increasing chlorine contact time for the City of Glendive

The City of Great Falls engineering and construction loan will fund four separate projects. One project will be an engineering study to update the City's Water Master Plan. A second project will be an engineering study to evaluate the condition of the distribution system storage reservoirs. A third project is to replace existing deteriorated water mains. A fourth part is to refinance a previous main replacement project. The authorized loan amount is $3,000,000 and the loan closed on December 21, 2000. Replacement of existing deteriorated mains is on going at this time. This project will help Montana meet its intended use plan goals by protecting public health through replacing leaking and deteriorated pipes, by helping the public water supply improve its technical and managerial capacity in updating its water master plan and proactively addressing the maintenance of its storage reservoirs.

The City of Havre phase II loan is funding an upgrade of the city's existing 4.5 million-gallon per day (mgd) surface water treatment plant. Deficiencies in the sedimentation, filtration and disinfection capabilities of the plant will be corrected. The loan of $8,401,000 was closed June 1, 2000. Construction is ongoing and final completion is scheduled for October 31, 2002. This project will help Montana meet its intended use plan goals by ensuring the technical integrity of the project and funding a project that addresses public health protection through compliance with the surface water treatment rule.

The City of Helena construction loan funded the construction of a new water transmission main, pump station and reservoir to address deficiencies in service to the east side of the city. The total loan amount was $1,250,000. Helena's 1997 Water Master Plan Update identified the need for additional storage on the city's east side to improve the capacity and reliability of service to that pressure zone. Funding this project enables Montana to meet its intended use plan goals of ensuring the technical integrity of the project and funding a project that addresses public health protection by maintaining adequate water supply and pressures in the distribution system.

The Highwood County Water and Sewer District construction loan funded distribution system replacement and improvements, a new storage reservoir, well, and well control system. The total loan amount was $75,000. The District had not completed any significant improvements since the original construction of the water system in the 1940s and 1950s. Consequently, replacement and updating of the aging infrastructure was necessary in order to remain in compliance with drinking water regulations. Funding this project enables Montana to meet its intended use plan goals of ensuring the technical integrity of the project and funding a project that addresses public health protection by maintaining the reliability of the source, storage, and distribution systems.

The City of Kalispell loan financed the replacement of water mains. Two cast-iron water mains, approximately 68 years old and in poor condition and predisposed to leaking, were replaced. The final loan amount was $761,000. The project helped Montana meets its intended use plan goals by proactively addressing distribution system problems in order to maintain public health protection and by ensuring the technical integrity of the project.

The Missoula County Fairgrounds engineering and construction loan provided funding to improve the distribution system of this small public water supply. The improvements were

primarily to protect the potable water supply from many cross-connections within the system. The project was completed in June of 2001 and the final draw was made in November of 2001. The final loan amount was $206,194. This project helps Montana meet its intended use plan goals by addressing public health protection through cross-connection control and backflow prevention and by ensuring the technical integrity of the project.

The Town of Philipsburg Construction loan is being used to fund the construction of a new boost pump station, 3,200 l.f. of transmission main, and new telemetry and controls. The goal of the project is to provide and blend an alternative source of drinking water with the community's sole source to raise pH and bring the system into compliance with the EPA Lead and Copper Rule. The loan was closed in 1999 for design and the first phase of construction; the final phase bid in July of this year (2002) and is scheduled for completion in October 2002. The project will provide the community with a safe and dependable source of drinking water, thus ensuring compliance with state and federal requirements.

The City of Shelby loans were to: A) refinance a loan of $866,000 the city had with a private lender (Wells Fargo) that paid for previously completed distribution system improvements (including new storage) and B) fund additional distribution system improvements for $677,000 where aging and leaking water mains were problematic. The projects helped Montana meet its intended use plan goals by proactively addressing distribution system problems in order to maintain public health protection and by ensuring the technical integrity of the project.

The Town of Twin Bridges Construction loan funded a new above-grade steel water storage reservoir and the replacement of leaking and undersized distribution lines. A new telemetry system, pump controls, and water system storage building were also included in the scope of work. Construction began in 1999 and was completed in the fall of 2001. The construction loan has been closed. The project is helping the Town of Twin Bridges comply with federal and state requirements for storage and distribution and also to meet the capacity development goals and requirements of EPA and the Montana Drinking Water State Revolving Fund Loan Program

The City of Whitefish Phase II construction loan funded the construction of a surface water treatment plant adjacent to the city's Haskill Reservoir, a raw water intake and pump station on the shore of Whitefish Lake, and a transmission pipeline to deliver untreated water from the lake to the plant. The engineering loan was $400,000 and the construction loan was $5,839,000. Construction began in August 1999 and was completed in May 2001; the last loan disbursement was made in October 2001. This project helps Montana meet its intended use plan goals of ensuring the technical integrity of the project and funding a project that addresses public health protection through compliance with the Surface Water Treatment Rule.

SUMMARY OF LOAN ASSISTANCE:

A tabulation of aggregate information can be found in Exhibit 5, History of DWSRF Binding Commitments. This table tabulates the quarterly federal payments, totals quarterly SRF binding commitments and cumulative binding commitments, and calculates Montana's achievement of its 100% binding commitment grant condition. This fiscal year, the DWSRF maintained steady performance by executing project commitment agreements. The DWSRF completed SFY02 with binding commitments totaling 174% based on grant payments received four quarters earlier. We project in SFY03 that we will execute in excess of $8,000,000 in binding commitments. See Exhibit 6: DWSRF Projected Binding Commitments SFY03.

B. FIRST-ROUND FUNDED LOANS:

First-Round loans are financed with capitalization grants and state match. The DWSRF has financed the projects listed in Exhibit 3: DWSRF Capitalized Grant Closed Loans For SFY02.

C. RECYCLED FUNDED LOANS:

Recycled loans are financed with loan repayments from first round money and funds from transfers from the WPCSRF program the projects listed in Exhibit 4: Recycled Closed Loans For SFY02. There were no loans made that used recycled funds in FY02.

D. SOURCE OF FUNDS:

Two sources of funds are used to capitalize the DWSRF: (1) the Federal Capitalization Grant, which provides 80% of the DWSRF loan funds; and (2) the state match, funded through the sale of GO bonds, which provides 20% of the DWSRF loan funds. State legislation originally authorized the sale of up to $10 million in GO bonds to match federal grant funds. In the 1999 Legislative session an additional $10 million of GO bonds was authorized for state match bringing the total to $20 million. This amount is adequate to cover funds currently authorized for the program. $9,245,000 of GO bonds have been issued by the DWSRF program to use as state matching funds through SFY02. See Exhibit 1: Sources of DWSRF Funds through SFY02. In-kind services of $11,779 have been provided to the DWSRF program by DNRC as match to federal grant funds and were used for program administration. Also, $8,782,486 of funds have been transferred from the WPCSRF to the DWSRF for loans to date. See Exhibit 7 for a breakdown of transferred funds for SFY02.

E. FEDERAL FUNDS DRAWN BY THE PROGRAM:

Exhibit 8, SFY02 Summary of DWSRF Federal LOC-ACH Draws shows forty-six loan disbursement requests for $9,632,692, twelve administrative set-aside disbursement requests for $389,628 and 12 non-administrative set-aside disbursement requests for $814,286 were made for a total of $10,836,606 drawn on the Federal Letter of Credit, Automatic Clearing House (LOC-ACH) during SFY02.

F. SET – ASIDES

DWSRF Budget and Draws by Set-Asides displays the financial summary of these non-project activities, see Exhibit 9.

DWSRF Administration

The DWSRF set aside the maximum four percent from the capitalization grants for program administration. DEQ's contract with DNRC and other activities that occurred were:

- review and assistance during planning, design, project bidding and construction
- loan origination work, administering repayments
- preparation of bond issuance with state's bond counsel firm of Dorsey & Whitney
- financial modeling
- DWSRF program audit
- costs associated with the legislatively appointed advisory committee
- public comment processes

Small Systems Technical Assistance

Montana has set aside 2% (the maximum allowed) of its FY97, FY98, and FY99 Drinking Water State Revolving Loan Fund grants for small systems technical assistance, for a total of

$588,226. In addition, MDEQ has reserved the authority to set aside the 2% allocation of the FY00 and FY01 grants from future grants. No additional funds were set aside from the FY 02 grant, but an additional $125,000 are anticipated to be set aside from the FY 03 grant.

The set-aside is used for contracted services and administration of contracts. A contract was awarded in 1999 to Midwest Assistance Program of Montana to provide operation and maintenance technical assistance. Since implementation, the contractor has made over 450 site visits to small public water supplies for a total cost of $392,827. Evaluations of this service, conducted annually by MDEQ, indicate the program is successfully helping small public water suppliers to effectively maintain and operate their water systems. Contracted technicians help water system operators develop or enhance technical capabilities that assist them in meeting the capacity development requirements of the 1996 amendments to the Safe Drinking Water Act.

The most recent evaluation of the contract by DEQ DWSRF staff in May and June 2002 determined that the contract should be continued. The contract was renewed for state fiscal year 2003 (July 2002 through June 2003). The contracted services are provided to systems serving a population of 10,000 or less. Approximately 0.05 FTE is needed to provide contract oversight related to this set-aside.

Public Water Supply Supervision Set-Aside: Administration

This set-aside funded salaries, benefits and operating expenses for two water quality specialists recently hired and assigned to the Billings and Kalispell Regional Offices, respectively. (In addition, four new FTE are being proposed for next year, which will require approval of a budget amendment through the legislative Executive Planning Process.) All of these positions provide direct assistance to water suppliers in implementation of the Lead and Copper Rule, the Phase 2/5 rules, the Total Coliform Rule, the Consumer Confidence Report Rule, the Interim Enhanced Surface Water Treatment Rule, and Stage I Disinfection / Disinfection By-Products Rule. The set-asides also funded database development expenses associated with implementation of SDWIS/state and associated state-specific Oracle modules.

PWSS Source Water Protection (SWP)

Section 1452(g)(2)(B) of the SDWA allows Montana to set aside a portion of the capitalization grant to "administer or provide technical assistance through source water assessment programs." Set-aside funds in the amount of $75,000 were used in State FY02 to administer the Source Water Protection Program and to provide technical assistance to local communities in the development of source water protection plans.

The specific goals achieved in State FY02 were:

- Maintain and enhance public accessibility to spatial data essential to the local development of source water protection plans through the interactive spatial data query system,
- Provided training to PWS operators, managers, and local officials in using source water delineation and assessment reports to develop local source water protection plans,
- Provided outreach to communities on source water protection,
- Provided technical support to non-profit technical assistance providers relating to source water protection plan development.

Capacity Development

The 1996 Amendments to the Safe Drinking Water Act allow states to use SRF funds to establish authority to enforce capacity requirements and to implement a capacity development strategy. This ensures that all new and existing community and non-transient non-community public water supply systems have the necessary technical, financial and managerial capability to comply with all of the primary requirements of the SDWA. EPA also requires that systems demonstrate adequate capacity in these areas as a condition of approval for Drinking Water SRF loans.

The state could have lost substantial portions of initial capitalization grants if it did not develop and implement strategies to assist existing water systems with capacity development. DEQ avoided the first of these withholding provisions by obtaining approval in 2000 of the state's Capacity Development Strategy for Existing Public Water Supply Systems. Subsequent withholding provisions, of future capitalization grants, can be avoided by adhering to the approved strategy and complying with the requirements for reporting capacity development improvements to EPA.

The strategies are a methodology used to identify and prioritize public water systems in need of improving technical, financial, and managerial capacity (a complete copy of the capacity development strategies can be obtained from DEQ). Part of these strategies includes providing assistance to those systems by use of the set-aside funding. The state of Montana has over 1900 public water supplies. Given the large number of systems and a shortage of staff with the requisite financial and managerial experience, the department has chosen to provide these services through a contractor. The department entered into a contract with the Midwest Assistance Program in March 2001 to provide these assistance services. In the first 16 months of the contract, MAP provided in-depth financial and managerial services to approximately 20 public water systems. The contract was renewed for State Fiscal Year 2003 (July 2002 through June 2003).

PWSS Operator Certification

This set-aside has been used for personal services and operating expenses for staff in the Operator Certification Program. Set-aside funds are used to pay portions of the salary and benefits for all three full-time staff positions, as well as program operating expenses.

In the past year, the program has certified over 1500 public water system operators, including operators for approximately 650 community systems and 230 non-transient non-community systems. Certification program activities include public outreach, collection and processing of applications, collection and processing of examination and certification fees, training, administration of exams, monitoring of continuing education credits, compliance monitoring, and assistance with formal enforcement activities. Over 90% of the public water supply systems in each category have certified operators.

The Certification Program Manager sent the draft program to EPA Region VIII and Headquarters in October of 1999 to request approval of our Operator Certification Program. Positive feedback for the program was been received from both EPA Region VIII and Headquarters, and the program was formally approved in December 2000.

The department requested and received approval for spending authority from the 2001 state legislature for very small water system expense reimbursement grant funding. The department also requested and received approval for another full-time operator certification staff person to administer this program. EPA has approved the grant application, and the reimbursement

program began making reimbursements in October of 2002. Expenses associated with mandatory training expenses incurred after July 1, 2002 are eligible for reimbursement.

Local Assistance and Other State Programs – Source Water Delineation and Assessment

Montana used funds from this set-aside for delineation and assessment. The Montana SWP Program was submitted to EPA in January 1999, following an extensive development process that included advisory council input as well as consideration of comments received through public meetings held around the state and an Internet based enhanced public participation project. EPA approved the program in November 1999.

Implementation of the Montana SWP Program continued through the completion of source water assessment reports for public water supplies by DEQ staff and by contractors with approximately 28% of the required reports either completed or in progress at the end of State FY02. Reports follow a standard format at described by the program plan. Additionally, Montana is incorporating monitoring waiver recommendations in each report in order to add value for recipient PWSs.

According to EPA, the target implementation deadline for Montana is April 24, 2003. Montana formally requested a target deadline extension through the end of State FY2006 in order to ensure adequate time is available to continue producing the high quality reports currently being completed. Staff level work plans have been completed based on the new implementation schedule end date.

VI. GRANT CONDITIONS AND CERTIFICATIONS

The State of Montana agreed to the following conditions outlined in the Operating Agreement. These items are discussed in more detail throughout the body of this report. To the best of our knowledge, DEQ and DNRC have abided by all requirements of state and federal law in the administration of this program.

(a) Assurance that the State has the authority to establish a Fund and operate the DWSRF program in accordance with SDWA.

The State of Montana's authority was re-certified and included with our applications for the FFY02 capitalization grant.

(b) Assurance that the State will comply with State Statutes and regulations.

(c) Assurance that the State has the technical capability to operate the program.

(d) Assurance that the State will accept capitalization grant funds in accordance with a payment schedule.

Please see Exhibit 8: DWSRF Projected vs. Actual Federal LOC-ACH Draws.

(e) Assurance that the State will deposit all capitalization grant funds in the Fund or Set-Aside Account.

(f) Assurance that the State will provide an amount equal to at least 20 percent of the

capitalization grant (State match) in the Fund.

(g) Assurance that the State will deposit net bond proceeds, interest earnings, and repayments into the Fund.

(h) Assurance that the State will match capitalization grant funds the State uses for 1452(g)(2) set -asides.

(i) Assurance that the State will use Generally Accepted Accounting Principles.

(j) Assurance that the State will have the Fund and set-aside account audited annually in accordance with Generally Accepted Government Auditing Standards.
Please see Appendix B.

(k) Assurance that the State will adopt policies and procedures to assure that borrowers have a dedicated source of revenue for repayments (or in the case of privately owned system, demonstrate that there is adequate security).

(l) Assurance that the State will commit and expend funds as efficiently as possible, and in an expeditious and timely manner.

(m) Assurance that funds will be used in accordance with the Intended Use Plan.

(n) Assurance that the State will provide EPA with an Annual Report.

The submission of this document will fulfill the State of Montana's responsibility to submit a report.

(o) Assurance the State will comply with all Federal crosscutting authorities.

(p) The state agrees that it will conduct an environmental review and a determination will be executed and distributed using a state process consisting of the same level of environmental detail required under the state Environmental Review Process for the Drinking Water SRF Program.

All construction projects that received assistance during SFY02 were reviewed and approved using the Montana Environmental Policy Act (MEPA). It was determined that no Environmental Impact Statements were necessary. An Environmental Assessment was prepared and a Finding of No Significant Impact was issued for all projects.

(q) The use of set-asides for Administrative Expenses, Small Systems Technical Assistance, State Program Management (Public Water Supply Supervision, Source Water Protection, Capacity Development, and Operator Certification), and Local Assistance and Other State Programs (Source Water Delineation) will be identified each year in the IUP and established in accordance with the Drinking Water SRF Program Guidelines.

(r) Specific Requirements under Title XIV

1. In accordance with Section 1420(a) of the Safe Drinking Water Act, the state has the authority to ensure that all new community water systems and new nontransient, noncommunity water systems commencing operation after October 1, 1999, can

demonstrate technical, managerial, and financial capability with respect to each national primary drinking water regulation in effect.

EPA has reviewed and approved Montana's capacity development authority and strategies. Administrative Rules that implement Montana's strategies became effective on September 10, 1999.

2. The state currently has a water and wastewater treatment plant operators certification program within the Permitting and Compliance Division, Department of Environmental Quality.

In addition, the following conditions were given with the Capitalization Grant Award. To the best of our knowledge, DEQ and DNRC have abided by these requirements as well.

- The recipient agrees to ensure that all space for conferences, meetings, conventions, or training funded in whole or in part with Federal funds complies with the Hotel and Motel Fire and Safety Act of 1990.

- EPA Order 1000.25 Recycled Paper – DEQ is using recycled paper for printing reports to be delivered to EPA.

- Minority Business Enterprises/Women Business Enterprises (MBE/WBE) Utilization Under Federal Grants – During SFY02 loan recipients were required to comply with all Federal requirements concerning Disadvantaged Business Enterprises (DBE) Utilization either by project specification or submitting appropriate reports during construction.

- The state's fair share goal for DBE participation is 5% for SFY02 (2% MBE, 3% WBE). Refer to Exhibit 10 for the summary of the DWSRF Loans- MBE/WBE for contracts awarded during SFY02.

VII. CURRENT STATUS AND FUTURE ACTIVITIES

The DWSRF continues to use US Bank as its trustee to manage funds and accounts established under the program. To date this arrangement has been very beneficial. DNRC has internet access to US Bank accounts, which has made monthly reconciliation of WPCSRF and DWSRF accounts more timely. D.A. Davidson and Co. and Piper Jaffray Inc. continue to act as the DWSRF bond underwriters and financial advisors. Dorsey & Whitney will continue to act as DWSRF bond counsel for the general obligation bonds issued in future fiscal years.

Also, DEQ has begun work on the development of a complete database, which ultimately will include links with the DWSRF, the PWSS program, and fiscal services in both DEQ and DNRC. The Planning Division has a .5 FTE position for development of the WPCSRF and DWSRF databases. This person is coordinating database development and serves as liaison between SRF program staff and DEQ's data processing staff. The target is to have the system fully operational by the start of the next state fiscal year, 2004, which also will facilitate federal reporting.

The following schedule indicates the key dates for continuation of the Drinking Water State Revolving Fund Loan Program in SFY03:

SFY03 ESTIMATED KEY DATES	ACTIVITY
August 2002	Held DWSRF bi-monthly meeting
October 2002	Held DWSRF bi-monthly meeting
December 2003	Hold DWSRF bi-monthly meeting
February 2003	Hold DWSRF bi-monthly meeting
Spring 2003	Hold infrastructure financing workshops to promote and market DWSRF program
April 2003	Hold DWSRF bi-monthly meeting
May 2003	Attend Region VIII all states meeting
June 2003	Hold DWSRF bi-monthly meeting

VIII. GLOSSARY OF ACRONYMS AND INITIALIZATIONS

ACH	Automatic Clearing House
AWWA/MWEA	American Water Works Association/Montana Water Environment Association
BAN	Bond Anticipation Note
CIFA	Council of Infrastructure Financing Authorities
DBE	Disadvantaged Business Enterprises
DEQ	Montana Department of Environmental Quality
DNRC	Montana Department of Natural Resources and Conservation
DWSRF	Drinking Water State Revolving Fund
EPA	Environmental Protection Agency
FFY	Federal Fiscal Year (which begins October 1 and ends September 30)
GAN	Grant Anticipation Note
GO	General Obligation
IUP	Intended Use Plan
LT2ESWTR	Long Term 2 Enhanced Surface Water Treatment Rule
LAC	Legislative Audit Committee
LAD	Legislative Audit Division
LOC	Letter of Credit
MBE	Minority Business Enterprises
MPDES	Montana Pollution Discharge Elimination System
NPS	Nonpoint Source
NMP	National Municipal Policy
PPAD	Planning, Prevention and Assistance Division
PPL	Project Priority List
PWSS	Public Water Supply Supervision
RSID	Rural Special Improvement District
SDWA	Safe Drinking Water Act
SFY	State Fiscal Year (which begins July 1 and ends June 30)
SID	Special Improvement District
SWP	Source Water Protection
TFAB	Technical and Financial Assistance Bureau

TSEP	Treasure State Endowment Program
USDA – RD	United States Department of Agriculture, Rural Development
W_2ASACT	Water, Wastewater and Solid Waste Action Coordinating Team
WBE	Women Business Enterprises
WPCSRF	Water Pollution Control State Revolving Fund